



Treasury Inspector General for Tax Administration

ACTIONS HAVE BEEN TAKEN TO ADDRESS DEFICIENCIES IN THE QUESTIONABLE REFUND PROGRAM; HOWEVER, MANY CONCERNS REMAIN, WITH MILLIONS OF DOLLARS AT RISK

Issued on May 31, 2007

Highlights

Highlights of Report Number: 2007-10-076 to the Internal Revenue Service Chief, Criminal Investigation.

IMPACT ON TAXPAYERS

The Internal Revenue Service (IRS) estimates fraudulent refund claims exceed \$500 million a year. The Questionable Refund Program (QRP), established to identify and prevent the issuance of fraudulent refunds, received harsh criticism from the National Taxpayer Advocate as a Program that was inefficient and ineffective and that did not afford taxpayers their rights. The IRS reevaluated its processes and procedures to address the Advocate's concerns. However, TIGTA believes several of these changes may adversely affect the IRS' ability to prevent issuance of millions of dollars in potentially fraudulent refunds.

WHY TIGTA DID THE AUDIT

This audit was initiated to evaluate the effectiveness of procedures for detecting fraudulent and potentially fraudulent refunds. In addition to the Advocate's concerns, Congress has held hearings urging the IRS to devote additional resources to and improve its detection of fraudulent refunds.

WHAT TIGTA FOUND

The IRS did not adequately respond to various warning signs, including five previous TIGTA reports, that the QRP was facing problems and becoming unmanageable. For Processing Year 2006, the Criminal Investigation function (function) discontinued freezing the subsequent year's return and started notifying taxpayers that their refunds have been delayed. TIGTA found these freezes can be effective if implemented correctly and reviewed timely; in 2005, they could have prevented issuance of over 20,000 fraudulent refunds totaling \$71.7 million.

The IRS needs to be more aggressive in the criminal and civil pursuit of fraudulent refunds. During 2004,

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the function identified over 3,000 schemes involving almost 118,000 returns claiming almost \$425 million in fraudulent refunds. However, as of March 2006, criminal investigations had been opened on only 172 schemes involving \$59 million in refunds. Further, the IRS did not always take civil actions to adjust fraudulent refund accounts or recover fraudulent refunds that were issued. Had the IRS taken civil action on earlier fraudulent returns, it could have collected \$27.5 million from future refunds. One reason certain types of cases are not referred for civil action is that current law requires the IRS to issue a statutory notice of deficiency to the taxpayers.

The IRS also did not verify certain types of refund returns, although during 2004, over 30,000 of these types of returns claimed over \$84 million in potentially fraudulent refunds.

WHAT TIGTA RECOMMENDED

TIGTA recommended the Chief, Criminal Investigation, working with other functions (1) reconsider placing a freeze on the subsequent year's return of returns identified as fraudulent; (2) revalidate the optimal time needed to release a freeze; (3) work with United States Attorney's Offices on the referral criteria for refund schemes; (4) initiate a legislative proposal to eliminate the requirement to issue a deficiency notice; (5) consider lowering the tolerance for sending cases to the Examination function; (6) reconsider the decision to exclude certain types of returns from the screening process; and (7) reemphasize the requirement to document how fraud was determined.

The IRS agreed with Recommendations 2, 3, and 7 and plans to take appropriate correction action; partially agreed with Recommendation 1; and neither agreed nor disagreed with Recommendations 4 through 6. For the latter four recommendations, the IRS plans to evaluate results from the 2007 QRP, make recommendations on any adjustments to procedures before the 2008 Filing Season, and agreed to work with relevant parties to discuss initiating a legislative proposal.

The IRS should take a leading role in pursuing a legislative change, while working with the Assistant Secretary for Tax Policy. A legislative proposal has the potential to improve tax administration while still protecting taxpayer rights. In addition, this change would allow the IRS to lower its tolerances, reduce the number of cases referred to the Examination function, and reduce the already limited resources needed to process these cases.

READ THE FULL REPORT

To view the report, including the scope, methodology, and full IRS response, go to:

<http://www.treas.gov/tigta/auditreports/2007reports/200710076fr.pdf>.

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